Are You Caring for a Disabled Family Member? Read This.

Article Highlights:

- Caring for Disabled Family Members
- Qualified Medicaid Waiver Payments
- 2014 IRS Announcement
- Exclusion Qualifications
- Mandatory Exclusion
- Earned Income Tax Credit

Many taxpayers prefer to care for ill or disabled family members in their homes as opposed to placing them in nursing homes, but doing this can be expensive, time-consuming, and exhausting. The government also recognizes home care as a means of reducing the government's costs in terms of caring for individuals who otherwise would be institutionalized (because they require the type of care that is normally provided in a hospital, nursing facility, or intermediate care facility).

To promote home care and reduce the government's institutional care expenses, Medicaid (through state agencies) pays home caregivers a small wage (usually reported on Form W-2 but sometimes on Form 1099-MISC) referred to as a Medicaid waiver payment to care for an individual in the care provider's home.

The IRS historically has taken the position that these payments were taxable income to the caregiver. However, in a notice issued in 2014, the IRS announced that, if the care met certain requirements, it would no longer challenge the excludability of these wages and instead would treat them in the same manner as excludable difficulty-of-care payments under the foster care payments rule. This is the case even when the caregiver and the individual being cared for are related.

Therefore, the exclusion can be applied to all future years and to all prior open years if the following requirements are met:

- The compensation must be required due to a physical, mental, or emotional handicap with respect to which the State has determined that there is a need for additional compensation.
- The care must be provided in the care provider's home. The "provider's home" may be the care recipient's home if the care provider resides there and regularly performs the routines of the provider's private life, such as sharing meals and holidays with family. In contrast a care provider who sleeps at the care recipient's home several nights a week but on weekends and holidays resides

with his or her own family in a separate home would not be providing the care in the care provider's home and would not qualify to exclude the Medicaid waiver payments received.

- The payments must be designated as compensation for qualified foster care or difficulty of care.
- To be excludable, the care payments are limited to a maximum of five individuals age 19 and older or ten individuals age 18 and younger.

Since these payments are now treated the same as qualified foster care difficulty-of-care payments, and since compensation for qualified foster care payments is mandatorily excluded, Medicaid waiver payments are also mandatorily excluded. That is, the care provider receiving these payments may not choose to include them in income.

This change is a double-edged sword, as some lower-income caregivers were previously able to qualify for the earned income tax credit (EITC) based upon this income.

The EITC is a refundable federal tax credit for lower-income taxpayers with earned income. The amount of credit is based on income and increases based on the number of children that the taxpayer has (qualified children include those under age 19 and full-time students under the age of 24; there is no age limit when the child is permanently and totally disabled).

Now, since these Medicaid payments are mandatorily excludable, the compensation no longer counts as earned income for the EITC.

On the other hand, those with substantial other income will welcome the IRS policy change, as it reduces their income and thus their income tax.

Still other care providers—those with earned income from other sources—may benefit from both the reduction of income and the EITC. The EITC phases out for higher-income individuals, so with the Medicaid waiver payment excluded, these individuals' modified adjusted gross incomes may be reduced enough to qualify for the EITC based on their other earned income. These individuals also may benefit from a lower income tax based upon the exclusion.

As you can see, the impact of the exclusion can be quite different depending upon your particular circumstances. If you are receiving Medicaid waiver payments and have not yet dealt with the exclusion, please call this office to see how excluding these payments might affect you.